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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY,
AND ECONOMIC DEVELOPMENT
DIVISION



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B-204637

SEPTEMBER 6, 1983

The Honorable James G. Watt
The Secretary of the Interior

Dear Mr. Secretary:

Subject: Compliance with the Department of the Interior's
Cost Recovery Program Could Generate Substantial
Additional Revenues (GAO/RCED-83-94)

We have reviewed the Department of the Interior's recently expanded cost recovery program as it relates to oil and gas activities on Alaska's Federal onshore lands. We found that Interior's bureaus and offices are not fully complying with the Department's requirement to identify and, where appropriate, seek recovery of costs for services which directly benefit firms and individuals.

During fiscal year 1982 more than \$1.5 million in potentially recoverable costs were incurred by Interior, and action was taken to recover only a small part of them. Similar costs of at least this amount are anticipated in the future. The Bureau of Land Management (BLM), the Minerals Management Service (MMS),¹ and the Fish and Wildlife Service (FWS) incur these costs in responding to requests for drilling permits and other services by specific individuals and firms involved in exploration, development, and production activities on Alaska's Federal lands. With few exceptions, however, the beneficiaries of these services are not being required to reimburse Interior for costs incurred, apparently because of the newness of the Department's cost recovery program, the lack of emphasis and priority being given to it, and the resulting unawareness of the requirement to reexamine these costs for possible recovery.

BACKGROUND

Legislation has long been in place which authorizes Interior to recover its costs for providing oil- and gas-related and other services. This legislation includes the Federal Land

¹On December 3, 1982, the Secretary of the Interior transferred all the MMS responsibilities discussed in this report to BLM.

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Policy and Management Act of 1976 (43 U.S.C. §1734 and 1764), the Mineral Leasing Act of 1920 (30 U.S.C. §185), and the Independent Offices Appropriation Act of 1952 (31 U.S.C. §483a). These laws give Interior considerable discretion in recovering costs for services rendered.

In May 1982 Interior reinforced these authorizations by issuing specific Department-wide cost recovery regulations to spur individual bureaus and offices to identify new cost recovery areas. These regulations require Interior to recover the costs of services that provide special benefits or privileges to an identifiable non-Federal recipient above and beyond those benefits that the public-at-large receives. Such services include processing lease applications, reviewing and approving drilling and other exploration permits, and monitoring environmental and mineral development activities. Costs may be recovered by charging standardized fees or billing for the actual costs of individual projects. The regulations also specify circumstances in which costs can be partially or totally exempted from recovery, such as when the receipts collected would be largely offset by the cost of collecting them, when cost recovery is prohibited by law, or for other reasons subject to the approval of Interior's Office of Financial Management.

Our review indicated that the type of oil and gas management costs identified in this report are potentially recoverable because, as the law allows and Interior guidelines require, they involve an identifiable recipient (e.g., a company) and are associated with an application for a privilege, such as issuance of a permit to do exploration or drilling.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of our review was to determine the extent of compliance with Interior's expanded cost recovery procedures (Departmental Manual Part 346 - Cost Recovery) as they apply to costs incurred by Interior in managing oil- and gas-related activities on Alaska's Federal onshore lands. Our review arose, in part, from a prior report entitled "Developing Alaska's Energy Resources: Actions Needed To Stimulate Research and Improve Wetlands Permit Processing" (EMD-82-44, dated June 17, 1982) which indicated that Interior was incurring extensive costs in managing and monitoring oil and gas activity on Alaska's Federal lands. BLM, FWS--and until December 1982, MMS--have been the primary components within Interior responsible for managing these oil and gas exploration and development activities. We interviewed BLM, MMS, and FWS officials in Alaska and Washington, D.C., and also officials in Interior's Office of Financial Management in Washington, D.C., which oversees the cost recovery program. We examined related agency records and reports.

To estimate the magnitude of unrecovered costs, we attempted to identify past costs and obtain estimates of future costs. Because precise records of such costs are not maintained, we asked BLM, MMS, and FWS officials in Alaska to provide us with their estimates of unrecovered oil and gas management costs. We did not verify their estimates but specified that they were to be for services provided to specific firms or individuals (i.e., to "identifiable recipients").

We performed our review in accordance with generally accepted government auditing standards.

ESTIMATES OF UNRECOVERED COSTS FOR
MANAGING OIL- AND GAS-RELATED
ACTIVITIES IN ALASKA

BLM's records for fiscal year 1982 and discussions with the BLM Alaska budgetary officer and the managers of monitoring and permitting activities indicated that unrecovered--but potentially recoverable--costs related to managing oil and gas activities for Alaska's Federal onshore lands amounted to approximately \$1.2 million. Examples of activities for which these costs were incurred include

- issuing and monitoring exploration and other permits,
- conducting field examinations before approving leaseholder operational plans, and
- conducting investigations to determine compliance with lease stipulations and permit provisions.

According to BLM's Arctic area manager and Alaska State Office officials, BLM's permitting and monitoring costs will probably continue at or near the same \$1.2 million level. Recently, BLM established a new \$25 application fee for geophysical exploration permits on the National Petroleum Reserve - Alaska, which will offset a portion of these costs. This fee, however, according to BLM's Arctic area manager, will cover only administrative processing costs. These costs represent a small portion of total costs incurred in permitting and monitoring exploration activity on the Reserve.

The onshore minerals manager of MMS in Alaska stated that MMS has no cost recovery program in effect for Alaska because identifying such costs is difficult. MMS does not charge for services such as issuing permits to drill, approving leaseholders' plans of operation, or monitoring compliance with permit and lease stipulations. MMS costs for these types of activities totaled approximately \$275,000 in fiscal year 1982. MMS estimated these costs in Alaska for fiscal year 1983 at

\$429,000, and at \$500,000 for fiscal year 1984. The increase is due primarily to additional expected activity on the National Petroleum Reserve in Alaska.

The regional director of the FWS in Alaska said that FWS cost reimbursement provisions for oil and gas management cover issuing and monitoring special use permits on the Arctic National Wildlife Refuge. This is the only FWS cost recovery effort ongoing in Alaska. The FWS official responsible for monitoring the only oil and gas production now occurring on a wildlife refuge in Alaska stated that he could not provide reliable estimates of remaining unrecovered costs because of the way costs are presently identified and recorded. He referred us to a former FWS official, who had supervised much of the past oil and gas development on these lands, as the best source for obtaining a cost estimate. This former official prepared an analysis for us that estimated the unrecovered permitting and monitoring costs associated with Alaska refuge oil and gas development at \$1 million to \$1.5 million for the 1957-81 period, an average of \$40,000 to \$60,000 a year.

BETTER COMPLIANCE NEEDED WITH
EXPANDED COST RECOVERY PROGRAM

Interior could realize substantial additional revenues by ensuring that FWS and BLM (which has assumed the cost recovery responsibilities previously held by MMS) fully comply with its expanded cost recovery program. On the basis of future cost estimates and expected activity levels provided by these organizations, as indicated above, at least \$1.5 million a year is potentially recoverable.

Interior's Office of Financial Management, under the Office of the Assistant Secretary for Policy, Budget, and Administration, provides cost recovery policy guidance to all other Interior organizations and oversees the new cost recovery regulations. Each bureau or office is to provide annual narrative reports to the Office of Financial Management identifying services subject to cost recovery and those considered appropriate for exemption. The Office of Financial Management approves cost recovery procedures prepared by all other Interior organizations and grants cost recovery exemptions.

The annual cost recovery report is supposed to identify all services provided to non-Federal entities by reporting bureaus or offices and indicate whether or not the service provided is subject to the departmental program. For any service considered exempt from cost recovery, the specific reasons are to be stated in the report. And, for those services considered subject to cost recovery for which costs are not being recovered, the report is to give reasons for the noncompliance and the planned

corrective actions to recover some or all of the costs, along with related target dates for implementing these actions. The first annual reports were to be submitted to the Office of Financial Management by August 1, 1982.

Our review of the first cost recovery reports disclosed that compliance with reporting regulations varied among MMS, FWS, and BLM. MMS did not file a report; it was excused because it was a relatively new organization. The FWS report did not identify, discuss, or analyze the recovery potential of oil and gas management costs. BLM currently charges for 27 leasing-related services and has proposed regulations for increasing or imposing fees for 9 others. BLM's report also identified some new areas for cost recovery, including new cost recovery procedures for certain right-of-way applications. However, BLM's report did not identify and analyze the possibility of cost recovery for the substantial oil and gas management costs discussed in this report. For example, costs for investigations to determine compliance with lease stipulations were among the unrecovered costs that were not analyzed in BLM's report.

We contacted the two systems accountants in Interior's Office of Financial Management who had done the research for, written, and were administering the cost recovery program. The senior official stated that the BLM and FWS reports were not in full compliance with cost recovery regulations. The reports did not reflect the extensive identification and analysis of new cost recovery areas that the regulations require. The official attributed the noncompliance to the program's newness. The Principal Deputy Assistant Secretary for Policy, Budget, and Administration, in commenting on our draft report, stated that the Office of Financial Management had followed up on reporting deficiencies and would continue to do so.

To determine whether oil- and gas-related costs are being analyzed for recovery potential at Interior's headquarters level, we contacted BLM's Chief of the Fluid Mineral Operations Division. This division is responsible for operations on leased Federal lands--for overseeing activities such as issuing permits to drill and approving operations plans.² We also contacted BLM's Chief of the Fluid Mineral Leasing Division, which is responsible for leasing Federal lands. These officials believed it was not Interior's policy to recover such costs, were not aware of Interior's new Department-wide cost recovery guidelines, and thus were not conducting the extensive cost recovery analysis the guidelines require.

²These are former MMS responsibilities that have been transferred to BLM.

CONCLUSION

Because BLM and FWS are not fully complying with cost recovery regulations, Interior may not be realizing the potential revenue that could come from being reimbursed or charging fees for oil and gas management costs incurred on Alaska's Federal onshore lands. Costs estimated to be at least \$1.5 million a year are potentially recoverable by Interior.

It has not been Interior's policy to recover such costs in the past, and some officials are apparently not aware of the requirement to reexamine this policy. The cost recovery potential could be enhanced if the Office of Financial Management ensures that BLM and FWS comply with Interior's expanded Department-wide cost recovery program.

RECOMMENDATION

We recommend that you instruct the Director of the Office of Financial Management to assure that bureaus and offices comply with the expanded program to recover appropriate costs for services provided the non-Federal sector. Specifically, bureaus and services in Alaska should identify unrecovered oil- and gas-related costs, evaluate the appropriateness of recovery possibilities, and institute collection procedures, where appropriate.

AGENCY COMMENTS

In commenting on a draft of this report (see enc. I), Interior did not dispute the fact that its bureaus and offices are not recovering oil- and gas-related costs such as those described in this report nor that they have not analyzed these costs for recovery potential--as required by departmental guidelines. Interior did state that it would require bureaus and offices to review their cost recovery criteria for Alaska oil and gas leasing activities. Interior, however, took issue with several statements in our draft report, as discussed below.

Specifically, Interior stated that the idea of potential cost recovery for noncompetitive oil and gas leases may have merit but that for competitive leases (the majority of Alaska leases), empirical evidence shows that charging various post-lease fees would tend to reduce the bonuses bid for the leases by the present value of the fees and thus have little net effect on revenues. It added that the administrative burden of establishing and collecting such fees could leave everyone affected worse off.

We examined two of the studies Interior cited as not supporting the recovery of postlease costs and do not believe they clearly substantiate Interior's position. One study compared bonus bids and royalties on the Outer Continental Shelf, and while it concluded that raising royalties could reduce bids, the other report³ concluded that in most cases royalty changes did not have a significant effect on bonus bids. In another review,⁴ several industry officials told us that a modest increase in the royalty would not significantly affect bonus bids. It would seem to us that the financial impact of various onshore fees would be less significant to industry than a royalty increase and its impact on bonus bids should also be less. We therefore believe it is premature for Interior to make its judgment because it has not estimated either the amount of revenue that cost recovery efforts would generate or the collection-related expenses. This estimate is part of the analysis that departmental guidelines require. The guidelines do not distinguish between competitive and noncompetitive leases. In addition, the fact that Interior already has found it feasible to recover costs for some oil- and gas-related services on competitive leases indicates that recovering the other costs identified in our report may also be possible.

Interior also stated that the examples of potential cost recovery areas identified in our report are by no means a complete listing of all such activities, nor is it absolutely clear in our report that the activities presented benefit the private sector more than the public sector. We agree that our listing is not complete. We only included examples to illustrate the types of activities (or services) involved and the magnitude of costs being incurred that warrant examination. The question of whether these activities benefit the private sector more than the public sector is not relevant. Interior's own guidelines specify that the costs for services that benefit firms and individuals are fully recoverable even if the public also benefits.

In addition, Interior stated that it is not necessary to direct the Office of Financial Management to follow up on non-compliance with departmental cost recovery guidelines because such followup has been, and will continue to be, conducted. We found, however, that despite Office of Financial Management followup efforts, the bureaus and offices have not complied with the guidelines, and as a result, costs such as those identified

³"Congress Should Extend Mandate to Experiment with Alternative Bidding Systems in Leasing Offshore Lands," GAO/RCED-83-139, May 27, 1983.

⁴"Interior Should Continue Use of Higher Royalty Rates for Offshore Oil and Gas Leases," GAO/RCED-83-30, Dec. 20, 1982.

in this report have not been examined for recovery potential. Thus, in our opinion additional followup is necessary to assure full compliance with the expanded program to recover all appropriate costs for services provided to the non-Federal sector.

Interior further stated that MMS, as a relatively new agency, was excused from submitting a 1982 cost recovery report and that its involvement in such leasing activities has since been transferred to BLM. Our final report has been revised to more fully recognize this transfer.

Finally, Interior stated that during our review, in discussing cost recovery with the Office of Financial Management, we did not talk with the Director of the Office of Financial Management and thus misinterpreted the Office's plans for followup. It should be noted that during our review we contacted the Office of Financial Management to discuss the cost recovery program and were referred to the officials responsible for setting up and administering the program. Our final report has been revised to reflect the positions taken in Interior's June 24, 1983, response to our draft report.

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As you know, 31 U.S.C. §720 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of this report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of this report.

We are sending copies of this report to the chairmen of the four committees mentioned above; the chairmen of the energy-related congressional committees; and the Director, Office of Management and Budget.

Sincerely yours,



J. Dexter Peach
Director



United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

JUN 24 1983

Mr. F. Kevin Boland
Senior Associate Director
Resources, Community, and
Economic Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Boland:

This is in response to your letter of June 3, 1983, which transmitted for our review and comment the draft General Accounting Office (GAO) report, "Compliance with the Department of the Interior's Cost Recovery Program Could Generate Substantial Additional Revenues" (GAO/RCED-83-94). Our response to the subject draft report is presented in two sections. The first section addresses (a) the cost recovery potential for the oil and gas activities on Alaska's Federal onshore leases and (b) the report recommendation. The second section addresses factual concerns we have with certain information contained in the draft report which we believe should be clarified before the issuance of the final report.

COST RECOVERY POTENTIAL/REPORT RECOMMENDATION

The idea of potential cost recovery for oil and gas leases which are issued non-competitively may have some merit. However, the majority of oil and gas leases in Alaska are currently being issued competitively by means of bonus bidding. There is empirical evidence to suggest that charging downstream costs (such as those suggested in the draft report) will tend to reduce the bonus bids by the present value equivalent of those charges. Consequently, in the case of competitive leases, charging fees becomes a matter of whether the Federal Government receives the equivalent revenues up front or receives them at the time the cost is incurred. In all likelihood, attempts at cost recovery for both competitive and noncompetitive oil and gas leases will leave the Federal Government no better off in terms of net revenues and, because of the administrative burden involved in establishing rates or fees and developing elaborate cost systems to capture actual costs, will leave everyone affected worse off.

The examples of the potential cost recovery areas identified in the draft report are by no means a complete listing of all activities involved in the oil and gas leasing program, nor is it absolutely clear that the listed activities benefit the private sector more than the public sector. It is important to note that the Bureau of Land Management (BLM) currently imposes a charge for 27 different mineral transaction services provided to the private sector that relate to both competitive and noncompetitive leases. BLM has proposed regulations for increasing or imposing new fees for nine additional services.

With regard to the recommendation contained in the draft report, it is unnecessary to instruct the Director of the Office of Financial Management to more aggressively follow up with bureaus and offices to remind them of compliance with Departmental

cost recovery policies. It appears that your representative misinterpreted information provided earlier by the staff of that Office. Further comments concerning this subject are offered in the "Factual Concerns" section of this letter. In any event, the Office of Financial Management has, on three separate occasions since May 1982, reminded bureaus and offices of the existence and applicability of the cost recovery policies contained in Part 346 of the Departmental Manual. Furthermore, follow up on the information contained in the bureau and office cost recovery reports filed as of August 1, 1982, has been effected. That Office will continue, as a matter of course, to review and follow up on all future bureau and office cost recovery reports.

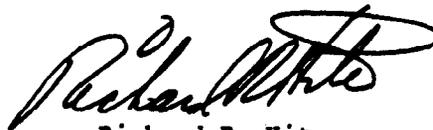
However, applicable bureaus and offices will be requested to review their cost recovery criteria with respect to the Alaska oil and gas leasing activities.

FACTUAL CONCERNS

Page 5, 2nd paragraph, second sentence. The Minerals Management Service (MMS) did not file a fiscal year 1982 cost recovery report; they were excused from such reporting requirements. At that point, MMS was a relatively new organization, subject to the normal fluctuation associated with organization startup. The question of MMS's involvement in such leasing activities is now moot since, as referenced in the footnote on page 1 of the draft report, the MMS responsibilities relating to such activities were transferred to BLM on December 3, 1982.

Page 5, 2nd full paragraph. The person with whom the GAO representative discussed cost recovery was not the Chief of Systems Accounting but was an employee of the Division of Financial Systems of the Office of Financial Management. The last sentence of this paragraph indicates that this employee stated the Office of Financial Management had no plans for following up with bureaus and offices on their fiscal year 1982 cost recovery reports. What the GAO staff was informed of was that the follow-up plan did not include on-site program reviews, since this is not within the resource capabilities of that Office, nor is it within the scope of that Office's responsibilities. This did not mean that the Office of Financial Management did not have plans to follow up on deficiencies on reports submitted to it. It simply meant that the Office does not perform on-site reviews. As previously stated, the Office of Financial Management has followed up on the fiscal year 1982 bureau and office cost recovery reports. It should also be noted that no one from GAO discussed the subject of cost recovery with the Director of the Office of Financial Management.

Sincerely yours,



Richard R. Hite
Principal Deputy Assistant Secretary -
Policy, Budget and Administration

GAO Note: Page references in this enclosure have been changed to agree with page references in the final report.